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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

BRIEF FOR THE RESPONDENT

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terests. The question was whether the transfer was more like a sale for cash, as in *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462, or more like a blending of two corporations into one, as in *Helvering* v. *Minnesota Tea Company*, 296 U. S. 378; *G. & K. Manufacturing Company* v. *Helvering*, 296 U. S. 389; and *Nelson Co.* v. *Helvering*, 296 U. S. 375. The Court concluded the transactions in the *LeTulle* and *Tyng* cases should be treated as the equivalent of sales for cash since the consideration received was promises to to pay cash. Obviously, an entirely different question is presented here.

A. The question has been decided favorably to the taxpayer in a line of decisions extending over a long period of years, and the law so established should not be changed except by legislative action.

The basic question is whether the transaction was a "reorganization" within the non-taxable reorganization provisions of the Federal Revenue Law. These provisions have been in effect in substantially the same form for over twenty years.[3] The same question arises in determining gain or loss of the security holders of the old company (Sec. 112 (b) (3)).

By ruling issued in 1924 the *Commissioner* took the position that this kind of a transaction *was* a "reorganization" under the 1921 Act, and that therefore the bondholders of the old corporation realized no deductible loss (I. T. 2071, III-2 C. B. 34). Taxpayers disputed this but the Commissioner was upheld in every case, and this Court refused to review the question on the taxpayer's application. *De Blois, et al.* v. *Commissioner*, (C. C. A. 1) 36 F.

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[3] Beginning with the Revenue Act of 1921, Sec. 202 (c) (2); c. 136, 42 Stat. 227, 230.

(2) 11 (1929); *First National Bank of Champlain*, 21 B. T. A. 415 (1930); *Rockford Dairy, Inc.*, 26 B. T. A. 501 (1932); *Commissioner* v. *Kitselman*, (C. C. A. 7) 89 F. (2) 458 (1937), certiorari denied, 302 U. S. 709; and see also *C. H. Mead Coal Co.* v. *Commissioner*, (C. C. A. 4) 72 F. (2) 22 (1934).[1]

From the time of the promulgation of I. T. 2071, *supra*, to date, the Federal Revenue Law has undergone more or less general revision no less than thirteen times.[2] Not once has Congress indicated a desire to change the law established by these decisions.[3]

The result has been that countless holders of securities in numerous corporations which were reorganized during the '30s have been allowed no deductible losses on the exchange of their old securities for new securities. It would

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[1] In *Commissioner* v. *Newberry Lumber Co.*, (C. C. A. 6) 94 F. (2) 447 (1938), the Commissioner took the opposite position. He was unsuccessful in the Circuit Court and, Supreme Court review having been refused in the *Kitselman* case, the Commissioner did not seek certiorari.

[2] Revenue Acts of 1924, 1926, 1928, 1932, 1934, 1935, 1936, 1937, 1938, 1939, 1940, Second 1940, 1941.

[3] The Commissioner refers to the Ways & Means Committee Report on proposed changes in the reorganization provisions by the Revenue Act of 1934 (Brief, pp. 29, 30). This report not only contains nothing indicating an intention to exclude a transaction such as that here from the reorganization provisions, but, on the contrary, there are indications in the Committee Reports on the 1934 Revenue Act that it was the intention *to keep insolvency reorganizations within the statute*, for fear bondholders would be entitled to deduct their losses upon exchanges made pursuant to such reorganizations. S. Rep. No. 558, 73d Cong., 2d Sess., p. 17; H. Rep. No. 704, p. 14. The Commissioner sought and obtained his decision in the *Kitselman* case three years after the 1934 Revenue Act was passed.

be an unusual situation where the case of such a taxpayer is still unclosed.

Under these circumstances it should require the most compelling reasons at this late date to reach the conclusion that a transaction of this kind is not a "reorganization" within the meaning of the statute. By its long continued failure to amend the law in the face of the decisions on the question favoring the Commissioner, it is to be assumed Congress approved those decisions. *District of Columbia* v. *Murphy*, decided December 15, 1941;[4] *United States* v. *Stroop*, (C. C. A. 6) 109 F. (2) 891, 893, 894. We respectfully submit contrary judicial decision now would smack of legislation (cf. *Scaife Co.* v. *Commissioner*, decided December 22, 1941). It would run counter to a long period of administrative practice inaugurated by I. T. 2071, *supra*.[5] If a change in the law as heretofore interpreted is deemed desirable Congress can easily make the change.

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[4] Wherein the Court said: "A contrary decision would * * * fail to give proper weight to the trend of judicial decisions, with which Congress should be taken to have been cognizant * * * ."

[5] Cf. *United States* v. *Hendler*, 303 U. S. 564, which was contrary to long continued administrative practice and which was nullified by the Revenue Act of 1939, Section 213, c. 247, 53 Stat. 862. Even the decision itself was set aside by Sec. 910 of the Social Security Tax Amendments of 1939, c. 666, 53 Stat. Part 2, p. 1402.

B. The foreclosure and receivership sales should not be recognized as transactions having income tax effect.

The Commissioner urges the Court to recognize the nominal purchases of assets by the bondholders' committee, acting as a reorganization committee, at the foreclosure and receivership sales as independent and closed transactions, with tax consequences accordingly.

This clearly is not a proper analysis of the matter for tax purposes. The bondholders' committee was merely the instrumentality through which the assets of Utilities were transferred to the taxpayer in exchange for its stock and warrants. What happened was all pursuant to a single plan of reorganization, approved by the court as such before the first step was taken. There is no principle more firmly established in the tax law than that in matters of this kind taxes are to be determined on the basis of what was ultimately accomplished, and separate tax effect will not be given to various conditional intermediate steps.[6]

The Circuit Court here was plainly right in concluding:

> "In effect, the committee was the agent of the old company in the transfer of the assets. When they bid them in at public auction they held them as trustee

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[6] Decisions of *all* of the Federal Circuit Courts of Appeals can be cited to this effect, including, among numerous others, *Portland Oil Company* v. *Commissioner*, (C. C. A. 1) 109 F. (2) 479; *Ahles Realty Corporation* v. *Commissioner*, (C. C. A. 2) 71 F. (2) 150; *Diescher* v. *Commissioner*, (C. C. A. 3) 110 F. (2) 90; *Helvering* v. *Elkhorn Coal Company*, (C. C. A. 4) 95 F. (2) 732; *Kuddell* v. *Commissioner*, (C. C. A. 5) 97 F. (2) 725; *Snowden* v. *McCabe*, (C. C. A. 6) 111 F. (2) 743; *Commissioner* v. *Kitselman*, (C. C. A. 7) *supra*; *Anheuser-Busch, Inc.* v. *Helvering*, (C. C. A. 8) 115 F. (2) 662; *Commissioner* v. *Schumacher Wall Board Corporation*, (C. C. A. 9) 93 F. (2) 79; *Prairie Oil & Gas Company* v. *Motter*, (C. C. A. 10) 66 F. (2) 309.

> for the new company. In principle and in substantial results the transfer was the same as if it were direct from the old company." (R. 66, 67.)[7]

The Second Circuit in the case of *Helvering* v. *New Haven & S. L. R. Co.*, 121 F. (2) 985, 988, No. 780, this Term, disposed of this contention by saying:

> "As for the effort of the Commissioner to atomize the plan, as it were, i.e. to separate it into several steps and treat the last as though it stood alone, it has been repeatedly repudiated." (Citing cases.)

In *Kansas City Railway Company* v. *Guardian Trust Company*, 240 U. S. 166, 176, 177, this Court recognized that a proceeding such as that here should be regarded "as one from the start to the close." See also 15 Fletcher on Corporations, Secs. 7270, 7271.

If the Court should disregard this well established principle in deciding the present case it is safe to say the resulting confusion in the administration of the tax law would be tremendous.

It is therefore submitted the present case should be decided by considering that, for tax purposes, what happened was a transfer of all of the assets of Utilities by it to the taxpayer in exchange for stock and warrants, which were distributed to the security holders and stockholders of Utilities as their interests then appeared. The question is whether, thus considered, the transaction constituted a "reorganization" within the definitions of Section 112 (g), with resulting applicability of Section 113 (a) (7).

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[7] It will be noted that the Fifth Circuit distinguished this case from *Commissioner* v. *Bondholders' Committee*, *Marlborough Investment Co.*, (C. C. A. 9) 118 F. (2) 511, Nos. 128, 1929 this Term, on the ground that there there was an independent unconditional foreclosure. (R. 66.)

C. The transaction here was a "reorganization" under Section 112 (g) (1), and basis of the taxpayer is basis of its predecessor under Section 113 (a) (7).

Section 112 (g) (1) defines "reorganization" as including five types of transactions. It is sufficient if the transaction here qualifies under any one of these. We submit it qualifies under all of them except Clauses A and C.

1. Clause B applies because the taxpayer acquired all of the assets of Utilities "in exchange solely for all or a part of its voting stock." In determining whether the exchange is solely for voting stock the assumption of a liability is disregarded.[8] Respondent claims Clause B does not apply, arguing the exchange was not "solely" for voting stock but "by hypothesis, cash for dissenters and the stock purchase warrants were also exchanged" (Brief, p. 21).

As to the cash, used "to buy out the interests of non-assenters" to the plan (Commissioner's Brief, p. 21), the Board found that this cash and cash to meet expenses was obtained by loan from a bank "which loan was assumed by the petitioner (taxpayer) and was later repaid by it" (R. 37). Therefore, under the amendment of Sec. 112 (g) (1) by the Revenue Act of 1939 the assumption of this obligation, or the taking of the property subject to this liability, is to be disregarded in determining whether the exchange was "solely" for stock.[9]

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[8] See Revenue Act of 1939, Sec. 213 (g) (1) and (2), c. 247, 53 Stat. 862, which amended retroactively Sec. 112 (g) (1) of the Revenue Act of 1934, the applicable statute.

[9] Respondent apparently has overlooked this retroactive amendment of Sec. 112 (g) (1) since his quotation of the statute does not reflect it (Brief, p. 33).

As to the warrants, the Commissioner claims, on the one hand, they are to be disregarded in determining whether the stockholders of the old corporation had a continuing interest in the taxpayer, and, on the other hand, that they are to be recognized in order to make inapplicable Clause B. If the warrants are to be disregarded for one purpose, we submit they should be disregarded for both purposes.[1] Giving full recognition to the warrants, however, does not make inapplicable Clause B, as the Commissioner claims. The warrants constituted *an interest in* voting stock. In a sense, they represented fractions of shares of voting stock, since they entitled the holder to acquire a share of stock for less than its value.[2] A distribution of such warrants has been characterized by this court as "essentially analogous to a stock dividend." *Miles* v. *Safe Deposit & Trust Company*, 259 U. S. 247, 252. It would be an unreasonable interpretation of the statute to say that a transaction otherwise qualifying as a "reorganization" under Clause B was not such simply because part of the consideration consisted of an interest in voting stock represented by stock purchase warrants.[3]

2. Clause D applies because, in substance, the transaction here was merely a "recapitalization" of a corporate

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[1] The Circuit Court apparently considered they should be disregarded (R. 65).

[2] See fn. 6, p. 6.

[3] While the Commissioner now repudiates it (Brief, p. 22; fn. 12), in an unpublished ruling in 1937 he expressed, what would seem to be the reasonable view, that the presence of such warrants does not remove the transaction from within the intent of a reorganization as defined in Clause B (1937 C. C. H., Vol. 3, Par. 6118; 1937 Prentice-Hall, Vol. I, Par. 501.)

business. The bondholders and other claim-holders exchanged their bonds for stock, and the stockholders exchanged their stock for valuable warrants to purchase stock. If the same result had been reached by continuing the old corporation in existence, there would have been a "recapitalization" and hence a "reorganization" without question, and the Commissioner presumably would so contend (*The Hoagland Corporation* v. *Helvering*, (C. C. A. 2) 121 F. (2) 962). Since in tax matters substance and not form controls, we submit the mere fact of the organization of a new corporate entity should not affect the result here. Both corporations were incorporated in Delaware (R. 31); both had the same assets; there was no new or different interest in the new corporate entity. It is therefore submitted that, giving the word "recapitalization" its commonly accepted meaning,[1] this transaction qualifies as such.

3. Clause E applies because there was "a mere change in identity, form or place of organization" of the business. The facts speak for themselves. The business enterprise continued unchanged. All those who had an interest in the old company were given an opportunity to continue in the new company on a basis which the court that approved the plan of reorganization considered fairly reflected their existing interests in the enterprise.

Since the transaction was a "reorganization" within the meaning of the statute, under Sec. 113 (a) (7) the basis of

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[1] See Cook on Corporations, 8th Ed., Vol. 5, Sec. 883, p. 4103.

the taxpayer is the same as it would be in the hands of Utilities, because an "interest or control" of 50% or more remained in the same persons. The statute is in the disjunctive,—interest *or* control. Either is sufficient. Both existed here. As to interest, not 50% but 100% remained in the same persons since there was no new or different interest in the transferee corporation. Furthermore, as above noted, presumably there was no change in relative interest. As to control, before the reorganization the bondholders held it as a practical matter, as evidenced by the fact that members of the bondholders' committee became directors of Utilities and constituted a majority of the board (R. 32). After the reorganization, the bondholders were the majority stockholders.

It is therefore submitted the transaction here constituted a "reorganization" under Sec. 112 (g) (1) and basis is the same as in the hands of the transferor under Sec. 113 (a) (7). The Commissioner claims this is inconsistent with the principles underlying the decisions in *LeTulle* v. *Scofield, supra,* and *Helvering* v. *Tyng, supra,* and that such a result would be unreasonable. These considerations do not justify this Court in ignoring the terms of the statute.[5] Furthermore, as indicated below, the Commissioner's contentions in these respects are unfounded.

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[5] Cf. *Groman* v. *Commissioner*, 302 U. S. 82; *Helvering* v. *Bashford*, 302 U. S. 454, where the Court adhered strictly to the letter of the reorganization provisions, although broader principles indicated a different result.

D. The LeTulle and Tyng cases are not in point and other decisions of this Court are in accord with the decision below.

At the outset it was indicated why, broadly, the *Le Tulle* and *Tyng* cases are not relevant (see pp. 9, 10, *supra*). They hold that a promise to pay cash is the equivalent of cash in determining whether a transaction is a sale or a "reorganization," whereas a different problem is presented here.[6]

Those cases were very little different from *Pinellas Ice Company* v. *Commissioner*, 287 U. S. 462. In all three cases the acquiring corporations were owned by interests different from the interests in the selling corporations. In the *Pinellas* case the consideration paid by the acquiring corporation was cash and short term notes: in the *LeTulle* case the consideration was cash and secured bonds: in the *Tyng* case it was cash and long term debentures. In each case the Court held the transaction was more akin to a sale than to a "reorganization". We submit that, for present purposes, the three cases are indistinguishable.

The *Pinellas* case was decided in 1933. Thereafter in pressing for the decision in the *Kitselman* case and claiming that the transaction there was a "reorganization" (although, unlike this case, the old stockholders there received no interest in the new corporation), the Commissioner found no difficulty in the *Pinellas* case, and the Seventh Circuit in reaching its conclusion did not consider the *Pinellas* case relevant. The taxpayer petitioned for certiorari: The Commissioner opposed,[7] and this Court denied the petition (302 U. S. 709), thereby apparently finding no conflict between that decision and the *Pinellas*

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[6] See Paul, Studies in Federal Taxation, Third Series, p. 160, fn. 468.

[7] See in that case the Brief for the Respondent in Opposition, pp. 12, 13.

case.[8] We submit, correspondingly, there is no conflict here with the *LeTulle* and *Tyng* cases.

The Commissioner invokes those decisions on the assumption that here there was no continuing stockholder interest. The fact is there was a continuing interest of stockholders of the old company. They were recognized under the plan by the issuance to them of valuable warrants to purchase stock (fn. 6, p. 6, *supra*). A substantial number of these warrants were exercised (R. 38). Furthermore, holders of about one-third of its bonds and more than one-half of its notes also held large amounts of preferred and common stock of the old company (R. 37, 38). As a consequence, *persons who were stockholders of the old company actually received under the plan shares of stock and warrants to purchase stock carrying potential voting control of the new company* (R. 38). The Commissioner urges the Court to disregard this circumstance as being without significance (Brief, p. 23, fn. 13). We submit it is a relevant fact that cannot be disregarded. It amply fulfills any possible requirement for a continuing interest on the part of the old stockholders. There is nothing in the statute warranting disregard of this factual situation.

Furthermore, in view of these facts the decision of the Circuit Court here is supported by a number of decisions of this Court. In *Helvering* v. *Minnesota Tea Company*, 296 U. S. 378, and in *G. & K. Manufacturing Company* v. *Helvering*, 296 U. S. 389, transfers for cash and minority stock interests[9] were held to be non-taxable "reorganizations"; and in *Nelson Co.* v. *Helvering*, 296 U. S. 375, a

[8] If the Court had considered there was such a conflict, presumably it would have granted the petition. Supreme Court Rule 35, Par. 5 (b).

[9] In the *Minnesota Tea* case the stock interest acquired was less than 8%. (See 28 B. T. A. 591, 592.) In the present case the stock issued on exercise of the "B" warrants alone constituted over 8% of all of the stock of the taxpayer (R. 36, 38).

transfer for cash and non-voting preferred stock was held to be a "reorganization." Such cases are by no means so clear as the present case because there one corporation was being acquired by another in which there were wholly different interests, whereas here there was in substance merely a recapitalization of a single continuing business enterprise.

E. Practical aspects of the problem do not call for a reversal of the Circuit Court's decision.

The Commissioner argues that it is unreasonable to permit the new corporation to use the basis of the old, claiming this would result in "an obvious tax windfall" (Brief, p. 13).

It leads nowhere to argue as to the reasonableness of corporate taxes. While a corporation is a fiction, nevertheless, it is recognized as a taxable person. As a result, income is taxed once to the corporation and again when it is distributed to the stockholders.[1] It might well be claimed that this double taxation itself is unreasonable. Yet, there is no possible basis for defeating it by judicial interpretation.

The present case concerns the tax of a corporation. The investment of its stockholders is a wholly immaterial consideration under our scheme of taxation. There is no call upon the courts to bring about a synthesis by judicial interpretation, and there is certainly no warrant for so doing when, as here, it would run counter to the terms of the statute.

Furthermore, we submit, more can be said for the reasonableness and equity of the taxpayer's position than can

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[1] The slight relief formerly accorded by exempting corporate dividends from normal individual tax (1934 Act, Sec. 25 (a) (1)) was abandoned beginning with the Revenue Act of 1936 (Cf. Sec. 25).

be said for that of the Commissioner. The corporate basis of the assets of Utilities as they existed at the time of the reorganization was $8,995,724.91. The Commissioner would reduce this basis to $1,766,694.98. Under the Commissioner's contention the difference of over $7,000,000 in corporate basis would evaporate, despite the fact that the same business enterprise continued unchanged and, to a large extent, the same persons continued to be interested in it. The result would be corporate taxation of fictitious corporate profits, and the consequences would be far more unreasonable than under the Circuit Court's decision.

Finally, if there is anything to this argument of the Commissioner, we submit the corrective is legislation and not judicial interpretation (Cf. *Scaife Co.* v. *Commissioner*, and *Helvering* v. *Lerner Stores Corporation*, decided December 22, 1941). It is not practicable for courts to try to shape tax laws in the light of such dubious and illusory considerations. What might seem reasonable to one, might seem unreasonable to another. A decision which might seem to produce a reasonable result in one case might establish a principle that would produce a wholly unreasonable result in another case. That way lies chaos in tax administration.

Conclusion

The judgment of the Circuit Court should be affirmed.

Respectfully submitted,

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Attorneys for Respondent.

January 1942.

Appendix

Revenue Act of 1934, c. 277, 48 Stat. 680, as amended by Revenue Act of 1939, c. 247, 53 Stat. 862:

Sec. 112. Recognition of Gain or Loss.

(*a*) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) * * *.

(*3*) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(*g*) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded; or the acquisition by one corporation in exchange solely for all or a part of its voting stock of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form or place of organization, however effected.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

Opinions Below

The memorandum opinion of the United States Board of Tax Appeals (R. 31-45) is unpublished. The opinion of the Circuit Court of Appeals (R. 63-67) is reported in 119 F. (2d) 561.

Question Presented

Pursuant to a "plan of reorganization," approved by the Delaware Chancery Court in an equity receivership proceeding, the respondent taxpayer acquired all of the assets of a predecessor corporation in exchange for all of the

common stock of the taxpayer, which was distributed to participating creditors, and warrants to purchase such stock, which were distributed in part to creditors and in part to former stockholders. The question is the taxpayer's basis for the assets so acquired.

Petitioner's Specification of Errors asserted that basis to the taxpayer was "cost to the bondholders' committee at the foreclosure and receivership sales," and was not cost to the old company (Petition for Certiorari, p. 5). On Brief the Commissioner, abandoning his previous position, now concedes that basis is not the bid price at the foreclosure and receivership sales,[1] but claims it is the fair market value of the property at that time[2] (Brief, p. 13, fn. 5; and see "Conclusion," pp. 30, 31). Therefore, the question now is whether basis is cost to the old company or fair market value at the time of the reorganization.

Statutes Involved

These are set forth in the Appendix, *infra*, pp. 23, 24.[3]

Statement[4]

The taxpayer is a Delaware corporation, organized June 27, 1934. It is the successor of Southwest Gas Utilities Cor-

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[1] $752,000 (R. 34).

[2] $1,766,694.98 (R. 38).

[3] The quotations from the statutes contained in the Appendix to the Commissioner's Brief (pp. 32-35) do not reflect the retroactive amendments made by the Revenue Act of 1939, c. 247, 53 Stat. 862. These amendments have significance here (see p. 15, *infra*).

[4] The summary statement of facts contained in the Commissioner's Brief (pp. 2-5) does not reflect a number of details considered significant.

poration (herein called "Utilities"). Utilities was organized in 1928, also under the laws of Delaware (R. 31).

The financial structure of Utilities consisted of:

171,915	shares of common stock
32,244	shares of $6.50 preferred stock
$2,871,500	First Lien and Secured Sinking Fund Gold Bonds 6½% Series
$ 126,000	Five-Year 6% Convertible Gold Notes
$ 31,945.42	Unsecured claims

(R. 33, 34, 36).

The $2,871,500 of First Lien Bonds were secured by stocks and bonds of subsidiary companies, which were pledged under an indenture (R. 32).

On May 1, 1932, Utilities defaulted in the payment of interest on its First Lien Bonds. On May 2, 1932 a bondholders' committee was organized to protect the interests of the bondholders. About 85% of the outstanding bonds were deposited with this committee. Members of the committee became directors of Utilities, and after October 7, 1932 constituted a majority of the Board. (R. 32.)

On April 10, 1933, a bill in equity was filed in the Court of Chancery in the State of Delaware by one of the bondholders, alleging insolvency of Utilities and praying for the appointment of a receiver. Utilities admitted insolvency in that it was unable to meet its obligations as they matured, and consented to the appointment of a receiver. Two receivers were appointed. (R. 32.)

On March 7, 1934, the bondholders' committee adopted a "Plan of Reorganization," under which participating security holders of Utilities would receive common stock and warrants to purchase common stock of a new corporation (the taxpayer) to be formed to take over the assets of Utilities. The new corporation was to have only common stock outstanding. The terms of exchange were:

Bondholders to receive 20 shares of common stock of the new company for each $1,000 principal amount.

Note and Unsecured Claim Holders to receive 2 shares of common stock and 20 Class "A" warrants for each $1,000 principal amount.

Preferred Stockholders to receive 1 Class "B" warrant for each share held.

Common Stockholders to receive 1 Class "B" warrant for each 50 shares held.[5] (R. 33, 34.)

A Class "A" warrant was the right to buy one share of common stock of the new company at $6.00 a share during 1934 and at an increased price of $1.00 per share for each year thereafter up to and including 1938. A Class "B" warrant was the right to buy one share of common stock of the new company at $10.00 a share during 1934 and at an increased price of $5.00 per share for each succeeding year up to and including 1938. (R. 33, 34.)

The members of the bondholders' committee were permitted to intervene in the receivership proceedings against Utilities, and on May 11, 1934 the Chancellor issued a decree approving the Plan of Reorganization. Pursuant to the Plan of Reorganization and by order of the Chancery Court, the assets pledged as security for the bonds of Utilities were sold by the trustee at foreclosure sale on June 25, 1934, and were bid in by the committee for $660,000. The unpledged assets of Utilities were bid in by the committee at public auction on June 18, 1934 for $92,000. The sales were confirmed by the Chancery Court. (R. 34.)

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[5] It will be noted that under the Plan every type of interest in the old company had a continuing interest in the new company.

The taxpayer was organized on June 27, 1934 (R. 31). Pursuant to the Plan of Reorganization, all of Utilities' assets were transferred to the taxpayer upon its organization (R. 38) and the common stock and "A" and "B" warrants of the taxpayer were issued in exchange for bonds, notes, claims and stock of Utilities, as follows:

curity	Total Amount	Amount Participating in Plan	SOUTHWEST CONSOLIDATED Securities Issued in Exchange Pursuant to Plan		
			Common Stock	A Warrants	B Warrants
nds	$2,871,500.00	$2,450,500.00	49,010		
tes	126,000.00	107,000.00	214	2,140	
her Unsecured Claims	31,945.42	31,945.42	62	620	
referred Stock	32,244 sh.	17,297 sh.			17,297
mmon Stock	171,915 sh.	57,470 sh.			1,148 7/50

(R. 36).

Non-participating security holders of Utilities received $106,684.06 in cash. The cash to make this payment and to meet expenses was obtained by loan from a bank. In connection with acquiring all of the assets the taxpayer assumed the loan and later repaid it. (R. 37, 26.)

Holders of $871,500 principal amount of bonds and $65,000 of notes of Utilities participating in the Plan of Reorganization also held 3,020 shares of preferred stock and 5,627 shares of common stock of that corporation. With respect to their holdings of bonds and notes, these security holders received 17,560 shares of common stock and 1300 Class "A" warrants of the taxpayer. With respect to their holdings of common and preferred stock of Utilities these individuals received 3,132 Class "B" warrants. (R. 37.)

Giving effect to this situation, the following table shows total distribution of common stock and warrants to pur-

chase common stock of the taxpayer to former stockholders of Utilities and to nonstockholders:

Class of security of Southwest Consolidated	Total issued by Southwest Consolidated	Issued to stockholders of Utilities	Issued to nonstockholders of Utilities
Common	49,286	17,560	31,726
Class "A" Warrants	2,760	1,300	1,460
Class "B" Warrants	18,445 7/50	18,445 7/50	—
Total	70,491 7/50	37,305 7/50	33,186

(R. 38).

Of the 2,760 Class "A" warrants issued by the taxpayer 1,760 were exercised, and of the 18,445–7/50 Class "B" warrants issued 4,623 were exercised, before they expired in 1938 (R. 38).

The cost to Utilities for the assets transferred to the taxpayer as of June 27, 1934 was $8,995,724.91. The fair market value of such assets on that day was $1,766,694.98.[6] (R. 38).

The taxpayer filed its first income and excess profits tax return for the period June 27, 1934 to December 31, 1934, in which it reported a net loss of $48,307.10 (R. 38). In calculating this loss the taxpayer considered its cost for the assets taken over from its predecessor was the same

[6] On the basis of such value of assets of the taxpayer its Class "A" warrants when issued had an indicated value of about $29 per warrant and its Class "B" warrants had an indicated value of about $25 per warrant, viz: The taxpayer issued 49,286 shares of common stock. The assets behind the stock had a value of $1,766,694.98. Such value of assets would give a value per share of about $35. A Class "A" warrant was the right to buy one share for $6 and a Class "B" warrant was the right to buy one share for $10. Thus, a Class "A" warrant-holder could get about $35 of value for $6 (a difference of $29) and a Class "B" warrant-holder could get about $35 of value for $10 (a difference of $25).

as the cost to its predecessor (R. 39). The taxpayer's Federal income and excess-profits tax return for 1935 also showed a net loss, which was similarly computed (R. 39).

In asserting the taxes in dispute the Commissioner claimed the cost of the total assets was the amount bid at the foreclosure sales. He then spread the aggregate purchase prices over the respective assets on the basis of their relative values (R. 25, 26). By so doing the Commissioner arrived at lower cost bases for the assets involved in the years in question than had been used by the taxpayer in filing its returns, and in this manner he arrived at net incomes for those years, with resulting taxes as asserted (R. 39).

The Board of Tax Appeals rejected the Commissioner's contention and held taxpayer's basis was cost to Utilities. This resulted in no deficiency for either year (R. 46). The Circuit Court affirmed (R. 67).

Summary of Argument

This case involves that type of reorganization where the financial structure of a single corporation is reconstituted. It does not involve that type of reorganization where the properties of two or more corporations are combined. It is thus entirely different from such cases as *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Tyng*, 308 U. S. 527, relied on by the Commissioner.

The question involved has been decided in a line of decisions extending over a long period of years. All of these decisions, except one, were in favor of the Commissioner. The rule of these cases requires an affirmance here. The law so established should not be changed at this late date except by legislation.

The Commissioner asks the Court to treat the transaction as having the same tax consequences as an ordinary

foreclosure. Since, however, the foreclosure and receivership sales here were merely steps in a single plan of reorganization, they should not be given tax effect. It is well settled that in matters of this kind conditional intermediate steps are disregarded. The statutory rule is applied to the net result. So considered, the transaction was a reorganization within three of the five definitions in Section 112 (g) (1), and the basis of the taxpayer is the same as the basis of its predecessor, under Section 113 (a) (7).

Under the plan, the stockholders of the old company were given valuable warrants to purchase stock in the new company. Also, holders of securities of the old company held large amounts of preferred and common stock of that company. As a consequence, persons who were stockholders of the old company actually received under the plan shares of stock and warrants to purchase stock of the new company amounting to more than 50% of the total number issued, and thus carrying potential voting control. Under these circumstances, the decision below is in accord with *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *G. & K. Manufacturing Co.* v. *Helvering*, 296 U. S. 389; *Nelson Co.* v. *Helvering*, 296 U. S. 375.

The result claimed by the taxpayer is fair and reasonable and is consistent with the Federal scheme of taxing corporate entities as such. The Commissioner's position would result in taxing fictitious corporate profits, since a large part of the basis of the old company would disappear.

ARGUMENT

The basis of the taxpayer's assets is the same as in the hands of its predecessor.

Introductory—This case involves that type of reorganization where a corporate financial structure is reconstituted (as distinguished from the case where the assets of two or more corporations are combined). Because of financial difficulties the bondholders agreed to exchange their bonds for stock[7] and the stockholders agreed to exchange their stock for valuable warrants to purchase stock.[8] The same persons who had an interest in the old company were given a continuing interest in the new company, except that after the reorganization their interests were represented by different types of securities than before. It is to be assumed their relative economic positions remained unchanged. Otherwise, the plan would have been unfair, and the plan had judicial approval. The business entity continued unchanged.

The situation is totally different from that involved in *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Tyng*, 308 U. S. 527, relied on by the Commissioner. In each of those cases the assets of one corporation were transferred to another corporation which was owned by different in-

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[7] In so doing the bondholders did not in a realistic sense substantially change their position. They were already joint heirs in the fortunes of the business and, as a practical matter, were no less co-owners before the exchange than they were after it. Dewing, Financial Policy of Corporations, Fourth Ed., Vol. 1, pp. 169, 170; Berle and Means, The Modern Corporation and Private Property, pp. 279, 280; Graham and Dodd, Security Analysis, 2nd Ed., p. 69.

[8] See fn. 6, p. 6.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

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SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to corporation where control of property remains in same persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.